Financial Markets

Irving Trust

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A sleeping giant awakened as the Federal Reserve began to exercise for the first time its long-dormant powers under the Credit Control Act of 1969. Monetary controls of a form hithertofore only a subject for speculation at academic conferences were suddenly in place. And even veteran Fed watchers by week's end were only beginning to grasp the dimensions of some of the precedents that are being established. Reserve requirements, which formerly have only been set on deposit liabilities, are now being applied to assets in the form of unsecured consumer credit and will affect not only banks, but also finance companies, department stores, money funds, and oil companies. In addition, the Fed is, for the first time, asking banks to hold their loan increases within a quantitatively specified guideline. Paul Volcker promised that the new controls would be removed as soon as possible, but the feeling remained that powers once exercised would be easier to use again.

It appears that some of the new controls could have a significant economic impact; the effect of some of the others is debatable. One of the potentially most significant actions is the limitation on loan growth. If the banks hold their loan growth to 6%-9%, a credit crunch could develop, unless the recession takes hold soon. True, over the last six months or so, loan demand has been relatively sluggish, but it is also fickle. Earlier, loans at the large weekly reporting banks had been rising at a 20% annual rate; if such a rate of increase were to occur again, it would quickly come into conflict with the new guidelines. The toughened marginal reserve requirement is also significant. With the base reduced, many more banks may now find additions to their managed liabilities subject to the marginal requirement, which has been increased from 8% to 10%; banks subject to the marginal requirement face a substantial increase in the marginal cost of funds. On a 90-day C.D., there is, in effect, an 18% reserve requirement; at current rate levels, the effective cost is raised about 400 basis points above the rate paid on the market.

On the other hand, many analysts think the controls on credit cards will be more notable as a nuisance than as an effective means of reducing consumer demand. Many card issuers were already trying to curb their use and to increase their pricing because the cards have been unprofitable. The marginal reserve requirement on card credit will simply nudge issuers a little more in a direction they were already going. Many analysts think the economic effect of the marginal reserve requirement on the money funds will also be nominal. Smaller investors will still find the funds attractive even if their return is reduced by the reserve requirement, while large investors who find their returns reduced will now bypass the funds and invest directly in many of the same instruments that the fund would have bought anyway.

Rates on the money market have settled back down since the terms of the anti-inflation package were announced. Fear of the unknown is always a powerful force in the markets, and the scramble for funds before the announcement was, in effect, a demand for insurance. Now, rates will depend more on the actual need for funds and the amount the Fed is willing to provide. If the recession takes hold in the next month or two, the announcement of the anti-inflation package may have marked this cycle's high water mark for short-term rates.

Gordon B. Pye

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Money Market Rates

	3/21/80 (noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company			
Short-term loans to substantial depositors with highest credit rating	19.00%	18.50%	11.75%
Effective since	3/19/80		
Discount Rate at Federal Reserve Bank	13.00	13.00	9.50
Federal Funds	17.25	17.00	10.06
Repurchase Agreements	12.50	13.00	9.70
U.S. Treasury Issues - Yields			
Bills			
3 months	16.10	16.04	9.90
6 months	16.66	16.75	10.05
1 year	16.15	15.85	10.12
Coupons			
2 years	15.05	14.70	9.75
4 years	13.69	13.38	9.21
7 years	12.93	12.70	9.14
10 years	12.71	12.42	9.12
Long Bond	12.25	12.20	9.03
Negotiable Certificates of Deposit-Secondary Market			
1 month	17.50	18.00	9.95
3 months	18.00	18.25	10.13
6 months	18.10	18.50	10.40
1 year	17.50	17.50	10.60
Bankers' Acceptances			
1 month	17.60	17.80	9.85
3 months	18.00	18.10	9.93
6 months	18.20	18.50	9.95
Eurodollar Deposits			
1 month	18.00	18.50	10.31
2 months	18.69	19 13	10.44
3 months	18.94	19.13	10.56
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	6.00	15.00	6.00
1 month	16.25	16.50	9.75
3 months	15.00	15.00	9.75
Bank Holding Companies			
1 month	16.50	16.75	9.75
Dealer Placed:			
3 months	16.88	17.00	9.90
New Aa Corporate Utility Bond	14.15	14.50	9.85
Tax Exempt			
6 month Project Notes	7.20	7.25	5.15
12 month Project Notes	N/A	N/A	5.50
20 year AAA Bond	9.10	9.00	5.85

This information represents prevailing market yields. It should not be construed as an offering. All yields are on the offered side of the market.

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